

# **MARAUDING THE MIDDLE CLASS**

**REPUBLICAN TAX BREAKS FOR THE RICH**

*An analysis of the GOP tax scheme  
and its impact on national priorities*

**A Special Report of the  
U.S. Senate Budget Committee Democratic Staff  
Frank R. Lautenberg, Ranking Member**

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## Introduction

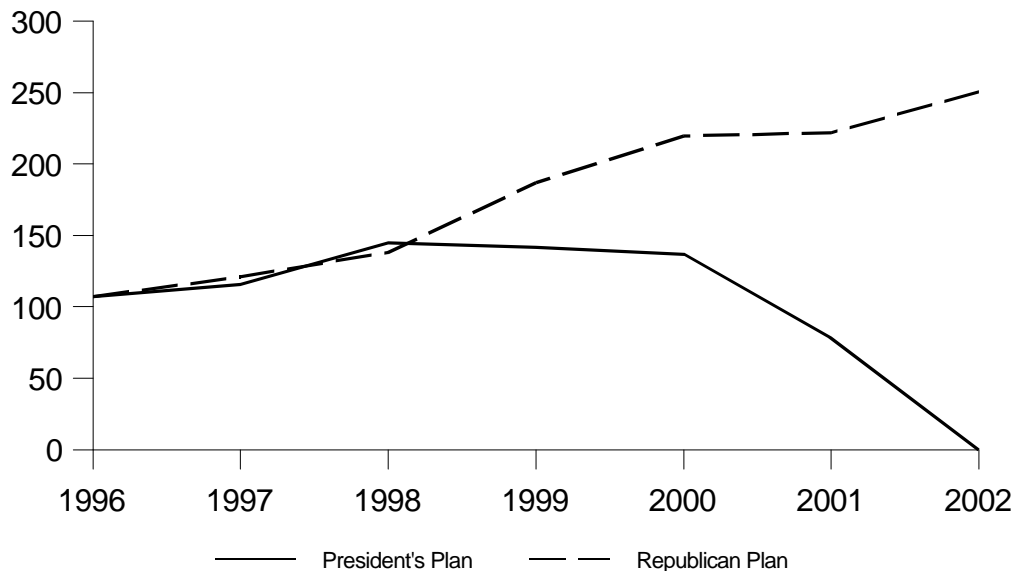
In January, the Senate Republican leadership introduced two bills that provide massive new tax breaks, primarily for higher-income Americans. The leadership made enactment of S.1 and S.2 top priorities for the 105th Congress.

In the first five years, the tax breaks in these measures cost \$200 billion. Over the next five years, costs rise by 60 percent, for a ten-year total of \$525 billion. In the subsequent ten-year period, the revenue loss increases dramatically, to more than \$760 billion.<sup>1</sup>

Not a single dime of these Republican tax breaks is paid for in the bills themselves, or in an overall budget plan for 1998. As a result, the Republican tax scheme would dramatically increase the budget deficit. If the Republican tax bills were enacted, deficits would rise from \$121 billion in 1997 to \$251 billion in 2002.<sup>2</sup>

## Projected Deficits

Billions of Dollars



<sup>1</sup> Lav, Iris, J., "Senate Leadership Tax Proposals: Mushrooming Tax Cuts for High-Income Taxpayers would Jeopardize Long-Term Budget Integrity", Center on Budget and Policy Priorities, February 26, 1997.

<sup>2</sup> Letter from Dr. June O'Neill, Director of the Congressional Budget Office, to Senator Frank R. Lautenberg, March 13, 1997.

Since Republicans assert that they support balancing the budget by fiscal year 2002, providing tax breaks of this magnitude would require extreme cuts in programs that are critical to middle class Americans. These cuts would be far deeper than those proposed by the President in his balanced budget plan. Until now, however, there has been no discussion of these potential cuts. The Republican leadership has failed to offer a budget or to explain the reductions they intend to use to pay for their tax breaks. The American people have been kept in the dark about what the GOP tax scheme would mean for them.

The Chairman of the Senate Finance Committee said that he would “strongly oppose” an effort to slash proposed tax breaks. He added, “We are talking about a \$200 billion tax cut over five years and *that ain’t much.*” (emphasis added)

In stark contrast, President Clinton has proposed a budget that balances in 2002, based on estimates by the Congressional Budget Office.<sup>3</sup> The President's budget includes several tax cuts targeted to the middle class. However, by rejecting the Republicans' massive tax breaks for the wealthy, the President is able to protect important national priorities in education, environment, Medicare and Medicaid.

This analysis explains the depth of the cuts that would be required to pay for the Republican tax breaks and examines their impact on ordinary Americans. The report explores the kind of spending cuts Republicans are likely to make to pay for these massive tax breaks and still balance the budget in 2002. Under this scenario, the Republican tax breaks would result in cuts of up to *one-third* in areas such as education, environmental protection, crime prevention, transportation, and health care research. These cuts would dramatically reduce economic and other opportunities for ordinary Americans, and reduce the quality of life for the middle class.

In the coming months, the American people will have the opportunity to choose between the President's budget and the Republican proposal. We hope that this report will help Congress and the public make informed judgments about these competing approaches.

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<sup>3</sup> Letter from Dr. June O'Neill, Director, Congressional Budget Office to Senator Frank R. Lautenberg, March 4, 1997.

## Methodology

This report calculates the impact of the Republican tax breaks using the approach proposed by Senator Robert Dole during his presidential campaign in 1996.<sup>4</sup> Senator Dole advocated the enactment of extensive tax breaks paid for nearly exclusively through cuts in nondefense discretionary programs. Under Senator Dole's plan, nondefense discretionary programs would have been cut by nearly 40 percent.

This report evaluates the additional cuts that would be required in nondefense discretionary programs to offset the costs of the tax breaks included in the GOP tax scheme. Our focus is on the final year of a five-year budget agreement, in which the budget will be balanced.

To arrive at the appropriate figures, we have started with the baseline produced by the Congressional Budget Office (CBO), which anticipates the amount of spending that would be expected if current policies are continued. Using that baseline, outlays for nondefense discretionary programs are expected to total \$321 in fiscal year 2002.

To achieve balance in 2002, President Clinton has proposed cuts in nondefense discretionary spending totaling \$26 billion. This would represent an 8 percent reduction from the amounts required to maintain current policies. However, the President's budget provides a set of additional policies to ensure that the budget actually balances in that year, should economic or other conditions vary from the President's projections. The President does not believe that these "fail safe" policies will be needed, and recent economic data support that conclusion. However, if CBO's estimates prove correct, nondefense discretionary spending would be reduced by an additional \$10 billion in 2002, for a total cut of \$36 billion. This would amount to a reduction of 11 percent.

A comparison of the Republican tax breaks and the President's own revenue proposals shows that the additional tax breaks would lead to a deficit \$67 billion larger than under the President's plan. The \$67 billion figure is based on estimates by the Joint Committee on Taxation.<sup>5</sup> Assuming that these additional costs would be offset through cuts in nondefense discretionary programs, as Senator Dole proposed, the total cuts in these programs would amount to \$103 billion in 2002. This represents a cut from current policy of **32 percent**. These cuts are far deeper than a freeze or even last year's Republican. These cuts are **24 percent deeper than those made by the President** in his alternative budget. These nondefense discretionary paths are shown in the table below.

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<sup>4</sup> There are a number of other ways to estimate the impact of Republican tax breaks. An appendix to this report looks at an alternative approach, which distributes the cuts based on last year's Republican budget.

<sup>5</sup> The \$67 billion figure reflects the across-the-board capital gains break (\$15 billion), the tax break for those inheriting more than \$600,000 (\$6 billion), IRA liberalization (\$10 billion), a modified version of President Clinton's child tax credit that would provide more benefits to upper income taxpayers (\$21 billion) and foregone revenue from the President's proposals, such as eliminating corporate loopholes (\$14 billion).

This report explains what a 32 percent cut would mean for a range of domestic programs of importance to ordinary Americans. The 32 percent figure represents an average of the cuts that would be needed. Of course, Congress could propose higher levels for particular programs; however, any such increases would have to be offset by even deeper cuts in other programs.

### Nondefense Discretionary Spending in FY 2002

(\$ billions)	Spending Level	Real Reduction <sup>1/</sup>
CBO uncapped baseline . . . . .	\$320	0%
President's Budget . . . . .	\$294	- 8%
President's Alternative . . . . .	\$285	-11%
Freeze at 1997 level . . . . .	\$272	-15%
Last year's Republican budget . . . . .	\$245	-23%
<b><i>Republican Plan</i></b> . . . . .	<b><i>\$217</i></b>	<b><i>-32%</i></b>

<sup>1/</sup> Reductions from CBO's uncapped baseline of March, 1997, which represents the 1997 enacted level adjusted for inflation in each subsequent year.

## **Impact of a 32 percent Cut on Domestic Priorities**

Nondefense discretionary spending includes programs that rely on funding through annual appropriations. These include programs for education and training, environmental protection, law enforcement, transportation, and health research, among others.

In 1996, nondefense spending totaled \$267 billion, or about 17 percent of total Federal spending. Measured as a share of the economy, nondefense spending has fallen from 5.2 percent in 1980 to its current low level of 3.5 percent. A reduction of 32 percent would reduce this component of the budget to 2.2 percent of GDP, the lowest level since at least 1940.

A reduction of this magnitude would require a dramatic reduction in public investments that promote economic growth. These investments are primarily in the nondefense discretionary part of the budget, and include expenditures for major capital investment, research and development, and education and training programs. Deep cuts in these programs could harm our nation's economy in the future.

State and local governments are also likely to be hit hard by these reductions. Some discretionary programs viewed as “essential Federal functions” will be spared deep cuts. These include funds for operating Social Security and veterans programs. To the extent that these programs are cut less than 32 percent, other programs will have to be cut more deeply. State and local grants are likely to bear a larger share of the cuts since they are not tied to the central role of the Federal government. These cuts — on top of those in last year’s welfare reform bill and perhaps further cuts in Medicaid — would be difficult for States and localities to handle without reductions in crucial public services, or tax increases.

Federal grants help State and local governments finance programs covering most areas of domestic public spending. Federal grant outlays were \$228 billion in 1996, or 15 percent of total Federal outlays, and are estimated to increase to \$291 billion by 2002. Reducing the Federal commitment by a third would make it more difficult for States and localities to provide critical domestic services, such as public education, law enforcement, roads, water supply, and sewage treatment.

## **Denying Educational Opportunities**

- ▶ ***Head Start.*** A 32 percent cut (\$1.45 billion) in Head Start in 2002 would deny about 300,000 children aged 3-5 the opportunity to benefit from this effective pre-school program, which provides comprehensive child development, education and nutrition services.
- ▶ ***Education of the Disadvantaged.*** A 32 percent cut for the Title I program would eliminate reading and math assistance to about 3.5 million poor children. This is likely to

lead to reduced academic performance and fewer economic opportunities for many of these children.

- ▶ ***Children with Disabilities.*** A 32 percent cut in the Special Education program would reduce critical educational services that are now provided to 6 million children with disabilities. It also would make it impossible for the Federal government to meet its statutory goal of sharing 40 percent of the costs of special education. Today, the Federal government is providing only 8 percent of these costs, a level Senate Republicans have sharply criticized as irresponsible. But under a 32 percent discretionary cut, the Federal share would be reduced even further — to 6 percent or less by 2002.
- ▶ ***Pell Grants.*** A 32 percent cut in the Pell Grant program would deny college access to as many as a half a million students by substantially reducing the value of the grants. A Pell Grant to a very needy college student in 2002 would be \$1,000 less than the expected maximum grant of \$3,130. The last time the Pell Grant maximum fell below \$2,200 was fiscal year 1987. Adjusted for inflation, the effect of this cut would be even more dramatic. By contrast, the President proposes to increase the maximum grant to its highest level ever.
- ▶ ***Job Corps.*** A 32 percent reduction in the successful Job Corps program could lead to the closure of about 40 job centers, thus denying job training opportunities to an estimated 20,000 disadvantaged youths. Nearly 64,000 people are currently enrolled at 115 centers. This type of cut could mean that there would be fewer Job Corps centers in 2002 than there were in the late 1970s.



## **The Republican Tax Breaks**

The Republican tax plan, as embodied in S.1 and S.2, would increase the deficit by \$200 billion over the next five years. In contrast to the President's budget, the Republican plan includes no proposals to offset any of these costs.

The Republican tax breaks greatly increase the deficit in the first five years and then the costs explode in future years. In fact, these tax breaks will swell to \$325 billion from 2003 to 2007, a 60 percent increase. The Republican tax package will cost more than the tax breaks contained in the final version of the Contract with America budget that President Clinton vetoed in the last Congress.

A large component of the Republican tax plan is geared toward the very wealthy. The capital gains tax break would provide a windfall to persons with large holdings. In addition, the estate tax break would benefit those who inherit estates from the top 1 percent of wealthy individuals. This tax break would provide a windfall for people inheriting estates up to \$21 million. The IRA tax break included in the Republican proposals is similar to the President's proposal, but is more geared to those with higher incomes.

## **Weakening Environmental Protections**

- ▶ ***Toxic waste clean up.*** A 32 percent cut in the Superfund program would postpone new cleanup activities at as many as 50 of the most hazardous toxic waste sites and delay the completion of cleanups at 20 additional sites in 2002. These delays would subject communities to additional health risks, and impede economic development that could create many jobs.
- ▶ ***Clean water.*** A 32 percent cut in Clean Water programs could eliminate more than 250 loans to municipalities across the country to ensure that our lakes, streams and rivers are clean and safe. The likely result would be dirtier water, and perhaps additional health hazards.
- ▶ ***Inspection activities .*** A 32 percent cut in environmental enforcement could result in a reduction of more than 13,000 enforcement actions. This could prevent EPA from halting unlawful pollution, lead to worsening environmental conditions, and let many wrongdoers off the hook. Activities that could be affected include: asbestos inspections in public/commercial buildings, compliance with Clean Air Act standards, and the monitoring of the Nation's drinking water.

- ▶ ***National Parks and Refuges.*** A 32 percent cut in the NPS could eliminate maintenance at 90 national parks, while the U.S. Fish and Wildlife Service could eliminate funding for more than 100 wildlife refuges. This cut could also lead to increased entrance and activity fees.

## **Cutting Law Enforcement**

- ▶ ***Prosecuting Criminals .*** A 32 percent reduction in funding for the U.S. Attorney's office would mean that at least 19,000 fewer persons accused of violent crime, drug smuggling, and organized crime activity would be prosecuted and 11,000 criminals who otherwise would be serving prison sentences would instead be free citizens.<sup>6</sup>
- ▶ ***Prisons.*** A 32 percent cut in prison funding could reduce by 42,000 the number of prison cells available to hold serious offenders. This could mean that thousands of criminals would be left on the streets. By contrast, the President's budget provides full funding for the Federal prison system by the year 2002.
- ▶ ***Controlling Illegal Immigration and Drug Trafficking .*** A 32 percent cut in the Immigration and Naturalization Service could require the dismissing of 2,400 Border Patrol Agents. Since the preponderance of these Agents are deployed along the Southwest Border, it is likely that illegal immigration along the California, Arizona, New Mexico and Texas perimeter would rise.
- ▶ ***Byrne Grants .*** A 32 percent reduction could mean that 1,500 fewer formula grants would be made by states from the Edward Byrne Memorial State and Local Law Enforcement Assistance program. These grants give states broad assistance with the functioning of their criminal justice systems — with emphasis on violent crime and serious offenders — and with the enforcement of Federal drug laws.

## **Reducing Investment in Transportation**

- ▶ ***Federal-aid Highways .*** A 32 percent cut in this program would eliminate \$6.7 billion in federal assistance to the states for highway projects and improvements in 2002. In addition, to achieve a 32 percent cut in outlays in 2002, tight caps on obligations would have to be set by the Congress in the preceding years. Already, all levels of government are spending approximately \$15 billion less than the level necessary to maintain our highway system at its current level of performance.

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<sup>6</sup> The President's budget for 1998 includes funding for 2,940 criminal litigators within the U.S. Attorneys office. These litigators will prosecute roughly 60,000 defendants in cases relating to terrorism, organized crime, drug smuggling, and illegal immigration. Based on recent data, roughly 55 percent, or more than 35,000 of these defendants will receive prison sentences. The President's request increases funding for these criminal litigators through 2002 to keep up both with inflation and the anticipated increase in caseload stemming from intensified law enforcement efforts.

In addition, since the U.S. Department of Transportation estimates that each \$1 billion spent on transportation creates 40,000-50,000 jobs, a cut of this magnitude could result in the loss of approximately 300,000 jobs in 2002 alone.

- ▶ ***Federal Transit Administration*** . A 32 percent cut in FTA funding would reduce the amount available for key mass transit programs by about \$1.5 billion. This could adversely affect many of our nation's public transportation systems, particularly the smaller and medium-sized systems that depend more heavily on federal assistance and have fewer resources at their disposal. Transit agencies would have to either raise fares or reduce service, or both, to try to deal with reduced federal assistance. In addition, funding for the purchase of buses and rail vehicles would decline significantly, and transit new starts would be delayed or abandoned. Congestion and air pollution in major urban areas would increase because, as transit service is reduced, commuters would revert to automobiles.
- ▶ ***FAA operations*** . A 32 percent cut would severely harm FAA's ability to maintain safe skies. Airline traffic is expected to increase over the next few years, so FAA's increased workload will require more federal funding, not less. A cut of more than \$1 billion could result in a staff reduction of 10,000 employees, including many safety personnel (controllers, technicians, and inspectors). Efforts to modernize the air traffic control system could be harmed. The result could be much less frequent and less comprehensive inspections of aircraft and an insufficient number of controllers to handle current and projected volumes of air traffic.

## **Cutting Science and Energy Research**

- ▶ ***National Science Foundation***. A 32 percent cut in NSF would be \$800 million in 2002, and would result in the elimination of more than 4,500 research and education grants in science and engineering to universities and other research institutions.
- ▶ ***Department of Energy***. A 32 percent cut in the DOE would mean that civilian research-related activities performed at more than 20 Department of Energy's labs located throughout the country would be cut by more than \$700 million.

## **Harming Other Domestic Priorities**

- ▶ ***Veterans Medical Care*** . A 32 percent cut in the Veterans Administration could result in closing more than 250 VA medical facilities and counseling centers, could deprive more than 800,000 veterans access to VA medical care and could add more than 3 weeks to the waiting time for a service-connected compensation benefit claim.

- ▶ ***Housing.***The Section 8 program provides basic housing assistance for America's poor, disabled, and elderly. A 32 percent cut in this program translates into more than 800,000 fewer housing units. That means approximately 2.2 million people would lose housing assistance, including approximately 760,000 elderly and disabled Americans.
- ▶ ***CDBG.***Community Development Block Grants are used by cities to help finance housing rehabilitation, economic development, and large-scale physical development projects. On average, every dollar spent for CDBG leverages \$2.31 in private and other investment. A 32 percent CDBG cut would bring funding down to \$3.5 billion in 2002, 27 percent less than 1997. For many communities, that would be a substantial cut.
- ▶ ***Drug Elimination Grants .*** A 32 percent cut would mean that these grants, which are used to fight drugs and crime in public housing, would be reduced by \$107 million to \$224 million in 2002.
- ▶ ***Supplemental Food Program for Woman, Infants and Children (WIC) .*** WIC would be cut by \$1.4 billion dollars under this scenario. Nearly 2.5 million fewer women, infants and children would receive benefits. WIC provides supplemental coupons for specialized foods to low-income families as well as nutritional educational and health care referrals. Studies show that the WIC program improves birth outcomes and has reduced the incidence of childhood anemia.
- ▶ ***Low Income Housing Energy Assistance Program .*** A 32 percent cut in LIHEAP could mean that about 2.75 million households would find themselves without heating assistance. The LIHEAP program serves low income families and senior citizens who otherwise might not be able to afford heating in winter.
- ▶ ***National Institutes of Health .*** A 32 percent cut in NIH in 2002 would mean a \$4.5 billion reduction in funds for medical research from a projected level of \$14.6 billion. This would be \$2.8 billion below the Fiscal Year 1997 appropriated level. The \$4.5 billion cut is equivalent to the entire budget of the National Cancer Institute.

## Alternative Ways to Pay for Republican Tax Breaks

As explained above, this study has calculated the effect of the Republican tax breaks using the approach adopted by Senator Robert Dole in last year's presidential campaign. Senator Dole offset most of the costs of his proposed tax breaks by cutting nondefense discretionary spending. This approach seems likely to be adopted again, especially given strong public opposition to past Republican proposals for cuts in Medicare, Medicaid and other mandatory programs. However, considering their record in the past, it remains possible that the Republicans would choose other methods to pay for their large tax breaks.

To help explain an alternative scenario for offsetting GOP tax breaks, the table below shows the relative contribution of different categories of spending to last year's budget resolution.

### Distribution of Spending Cuts in Republican Budget: 1996

	<u>1996 GOP Budget</u>	
(\$ billions)	\$	%
Discretionary . . . . .	-233	34%
Medicare . . . . .	-158	24%
Medicaid . . . . .	- 72	11%
Other mandatory . . . . .	<u>-195</u>	<u>30%</u>
Total . . . . .	-657	100%

If Republicans chose to distribute the additional cuts to these programs, in addition to nondefense discretionary, both Medicare and Medicaid cuts would increase dramatically from the levels proposed by the President. Medicare would receive nearly one-quarter of any additional cuts, and Medicaid cuts would increase by 14 percent. The table below shows how dramatically the cuts in the President's budget for Medicare would rise under this scenario, over a five- six- and seven-year period.

**Distribution of Additional Spending Cuts to Medicare and Medicaid  
based on Previous Republican Budget**

(\$ billions)	<b>President's Budget</b>	<b><u>President's plus Republican Cuts</u></b>		
		<b><u>5-year (\$200)</u></b>	<b><u>6-year (\$256)</u></b>	<b><u>7-year (\$290)</u></b>
Medicare	<b>-88</b>	-138	-181	-239

Note: President's budget cuts assume alternative policies that achieve a balanced budget under CBO assumptions.

With the additional cuts, the cumulative reductions in Medicare would grow from the \$88 billion in the President's balanced budget to \$138 billion over five years. Over six years, cuts would increase to \$186 billion and the seven-year total would reach \$239 billion.

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